

# **Royalties Inflated By Patent Hold-Up Insufficient To Support Monopolization Claim: D.C. Circuit Rejects The FTC's Case Against Rambus**

by Jack Fitzgerald

## **Introduction**

The potential for abusive manipulation of standard-setting organizations (“SSOs”) has drawn substantial interest from technology companies and commentators. The concern, broadly stated, is that, through some form of subterfuge, a participant in standard-setting activities can profit by making its intellectual property rights (“IPRs”) indispensable to anyone who adopts the standard. In most standard-setting processes, the participants make their own IPRs available to standards adopters on reasonable and nondiscriminatory (“RAND”) licensing terms. Indeed, for many standards, the SSO participants have offered free licenses for any IPRs necessary to implement the standard. Concerns about the standard-setting process arise when, after its adoption, compliance with a standard suddenly appears to subject its adopters to substantial IP infringement liability, requiring the adopters either to pay hold-up royalties or exit the field of the market covered by the standard.

Reflecting those concerns and its own history of interest in standard-setting abuse, the Federal Trade Commission brought an antitrust enforcement action against Rambus, Inc., based on Rambus’s participation in (and profit from) the Joint Electron Device Engineering Council (“JEDEC”), an SSO responsible for solid state technologies including computer memory. In August 2006, the FTC issued a 120-page opinion finding that Rambus had engaged in monopolization by deceiving JEDEC in the early 1990s.<sup>1</sup> But the FTC’s SSO-related enforcement policy was called into doubt when the United States Court of Appeals for the District of Columbia Circuit rejected the agency’s enforcement action against Rambus.<sup>2</sup>

The FTC accused Rambus of exploiting its participation in JEDEC by hiding pending patent applications until the technology covered by those applications had been integrated into widely adopted industry standards. Rambus then sued other members of the SSO demanding inflated royalties that reflected its patents' blocking potential.

After completing administrative proceedings, the FTC found that Rambus' conduct was deceptive and exclusionary, and amounted to monopolization under Section 2 of the Sherman Act. The D.C. Circuit, however, held that the FTC did not sufficiently demonstrate that Rambus' conduct was anticompetitive, particularly because one of the Commission's alternative theories of monopolization was that a fully informed JEDEC simply would have required Rambus to commit to a lower, RAND royalty. Under that theory, properly analyzed, Rambus' conduct merely increased monopoly rents rather than creating the (admitted) monopolies themselves.

### **Background and FTC proceedings**

After Rambus filed a patent application in 1990 for a faster architecture of dynamic read access memory (DRAM), the company began participating in a JEDEC committee responsible for developing industry-wide DRAM standards.<sup>3</sup> Committee members were expected to disclose any relevant patents during the standard-making process so that JEDEC could design around those patents, or at least ensure that the technologies they embodied could be licensed to JEDEC members on RAND terms.<sup>4</sup> Rambus seemingly concealed various patent interests—in particular, amendments or continuation applications that Rambus already contemplated but had not yet filed—covering several technologies that ultimately appeared in the DRAM standards JEDEC adopted. Rambus waited for those standards to become “locked in.”<sup>5</sup> Only then did it aggressively seek to enforce its patent rights against JEDEC members.<sup>6</sup>

The FTC's theory was that Rambus' conduct was deceptive.<sup>7</sup> Since this deception was "linked" to the adoption of the JEDEC standards, and the JEDEC standards were linked to Rambus' monopoly power in the DRAM industry, the FTC asserted that Rambus' conduct was a sufficient cause of its monopoly so as to render Rambus liable under Section 2 of the Sherman Act.<sup>8</sup>

Although the FTC's complaint counsel initially lost before an FTC administrative law judge, the full Commission reversed and held Rambus liable. The FTC determined that Rambus deceptively failed to disclose patent interests in four technologies that JEDEC ultimately standardized. Those interests included issued patents, pending patent applications, and plans to amend those patent applications to add new claims. Each of these interests was sufficiently related to the original 1990 patent application so that Rambus' rights would relate back to that date.<sup>9</sup> Rambus' failure to disclose was deceptive, according to the FTC, because JEDEC policies required members to disclose patent interests related to standardization efforts.<sup>10</sup> The FTC found that "while JEDEC's patent disclosure policies were 'not a model of clarity,' members expected one another to disclose patents and patent applications that were relevant to technologies being considered for standardization," as well as "planned amendments to pending applications or 'anything they're working on that they potentially wanted to protect with patents down the road.'"<sup>11</sup> Based on this interpretation of the JEDEC disclosure policies, the Commission found that Rambus had willfully withheld information it was required to divulge and that, "the evidence and inferences from Rambus's purpose demonstrated that 'but for Rambus's deceptive course of conduct, JEDEC *either* would have excluded Rambus's patented technologies from the JEDEC DRAM standards, *or* would have demanded RAND assurances . . . .'"<sup>12</sup> The Commission concluded that the concealment "significantly contributed" to Rambus' obtaining a

monopoly in four technology markets relating to various DRAM attributes, rejecting Rambus' argument that other factors resulted in the dominance of its technologies (Rambus eventually admitted that it monopolized those markets).<sup>13</sup>

The FTC's remedial proceeding was equally groundbreaking. The Commission asked for further briefing on possible remedies.<sup>14</sup> Rambus argued that its current royalty rates were competitive and therefore any remedy should be limited to an order directing Rambus not to engage in further deceptive conduct. Commission staff, on the other hand, argued that the FTC should award the JEDEC members royalty-free licenses, since JEDEC would have adopted a standard that did not infringe Rambus' patents had Rambus disclosed them.<sup>15</sup>

The FTC struck a middle ground, imposing compulsory licensing with maximum royalty rates calculated through agency-directed ratemaking; those royalties were greater than zero but less than Rambus' current royalty rates.<sup>16</sup> In deciding on the remedy for Rambus' transgressions, the FTC noted that it refrained from compelling Rambus to give JEDEC members royalty-free licenses because there was insufficient evidence that, without the concealment, JEDEC would have categorically adopted different technologies in its standard. Rather, the Commission acknowledged the possibility that the technologies would have been adopted and the JEDEC members would have negotiated for reasonable royalties, and fashioned its own "reasonable" rates on that basis.<sup>17</sup> Although the Commission did not "relish imposing a compulsory licensing remedy," it determined that Rambus' conduct made it impossible for the market to determine a reasonable rate.<sup>18</sup> The FTC therefore settled on a royalty of between 0.25% and 0.5% for various types of JEDEC-compliant DRAM, for a period of three years, after which Rambus would no longer be allowed to collect any royalties. These rates were calculated based on what the FTC believed the JEDEC members would have negotiated had Rambus

disclosed its patent interests.<sup>19</sup> Rambus also was ordered to refrain from making misrepresentations or omissions to SSOs and required to employ an FTC-approved compliance officer to ensure that Rambus disclosed its patent interests to relevant SSOs in which the company participates.<sup>20</sup>

### **The D.C. Circuit Rejects The FTC's Monopolization Theory**

After what one observer described as a “feeding frenzy” on the FTC’s appellate counsel, the D.C. Circuit reversed, holding that the FTC failed to establish that Rambus’ conduct was exclusionary and thus amounted to unlawful monopolization.

First, the court said, the “critical question” was whether Rambus had engaged in exclusionary conduct to acquire monopoly power. Exclusionary conduct must have an “anticompetitive effect”—that is, it must harm the competitive process and thereby harm consumers, rather than merely harm competitors.<sup>21</sup> The FTC failed to carry its burden as plaintiff when it determined that, had Rambus disclosed its patent interests, it was equally likely that JEDEC would have designed around Rambus’ patents, or demanded assurances of a RAND license.<sup>22</sup> Accepting without deciding that the first outcome (preventing JEDEC from designing around the patents) was anticompetitive, the court rejected the notion that conduct that raised royalty rates amounted to monopolization. Because “an otherwise lawful monopolist’s use of deception simply to obtain higher prices normally has no particular tendency to exclude rivals and thus to diminish competition,” deceptive conduct alone, even if proven, was not enough to make out a Section 2 claim.<sup>23</sup> Instead, deception must “impair[] rivals in a manner tending to bring about or protect a defendant’s monopoly powers.”<sup>24</sup>

The court provided examples of this type of actionable deception. In the *Microsoft* case, the court found an antitrust violation where Microsoft tricked independent software developers

into believing that Microsoft’s software development tools could be used to design cross-platform Java applications when, in reality, they produced only Windows-specific applications.<sup>25</sup> Likewise, the Sixth Circuit found an antitrust violation where the defendant tobacco company misrepresented to retailers the sales strength of its products, causing those retailers to market its products more aggressively than competitors’ products.<sup>26</sup>

Because the FTC had left open the possibility that JEDEC would have adopted the Rambus technologies even if Rambus had disclosed the patents—so that JEDEC would have lost only an opportunity to secure a RAND commitment—the FTC had not proved an antitrust violation. The “loss of such a commitment is not a harm to competition from alternative technologies in the relevant markets.”<sup>27</sup> Rather, RAND commitments (and other reductions in price) tend to reduce competition, while high prices and constrained output created by a dominant market player actually tend to attract competitors.<sup>28</sup> Thus, the court vacated the FTC’s order.<sup>29</sup>

But the court did not stop there. Instead, it took the opportunity to express “serious concerns” about the FTC’s evidence that Rambus had deceived JEDEC at all. Characterizing as “murky” both JEDEC’s disclosure policies and what Rambus supposedly failed to disclose, the court noted that the FTC had relied “quite significantly” on a supposed obligation that JEDEC members disclose their work in progress on *potential* amendments to pending applications.<sup>30</sup> But in reviewing the record, the court discerned no evidence that JEDEC’s policies were in fact so broad. Instead, the FTC had “stretched” JEDEC’s written policies, supporting its interpretation of those policies primarily with “a few strands” of the inconsistent testimony of five former members.<sup>31</sup> JEDEC’s written policy in fact referred only to an “obligation of all participants to inform the meeting of any knowledge they may have of any patents, or pending

patents, that might be involved in the work they are undertaking.”<sup>32</sup> In sum, the court concluded, “the Commission has taken an aggressive interpretation of rather weak evidence.”<sup>33</sup>

### **Implications**

Although by reversing a high-profile enforcement ruling the D.C. Circuit dealt a setback to the FTC’s efforts to police abuses of the SSO process, much of the problem in this case stemmed from JEDEC’s vague disclosure policies and the FTC’s inability to pinpoint the actual effects of Rambus’ activity. “[P]atent hold-up” in SSO standardization processes remains important, and likely will remain a focus of FTC attention, although the agency may seek better evidence of the SSO’s behavior in the absence of deceptive conduct.

SSOs have become increasingly prevalent, particularly in high-tech industries driven by innovation and intellectual property, where standardization leads to substantial market efficiencies. That is why SSOs—even where they bring together competitors—are generally pro-competitive.<sup>34</sup> But the standard-setting process is potentially open to abuse. By adopting a particular standard, industry members often irreversibly invest in one technology. They necessarily forgo investment in alternatives and may not be able to switch without sacrificing significant investments and risking that their products will be incompatible with other, standard-compliant products.<sup>35</sup> This lock-in effect enables the owner of a patent crucial to an adopted standard to extract royalties disproportionate to the incremental inventive contribution of the patent.<sup>36</sup> Statistics show that, as a result, patents covering technology embodied in adopted industry standards are “*thirteen times* more likely to be litigated than comparable patents that do no not cover a standard.”<sup>37</sup>

The possibility of extorting inflated royalties from locked-in industry members creates a strong incentive for holders of relevant patents to conceal them from the industry until the

industry has adopted a patented technology in an entrenched standard. For that reason, SSOs typically have policies requiring their members to disclose patents and related interests *before* a particular standard is adopted, so that the organization may design around it, or at least fairly negotiate royalty terms. Although JEDEC had such a policy, it ultimately proved inadequate. This may be the most important practical lesson of the *Rambus* antitrust litigation.

Going forward, SSOs must anticipate that any ambiguities existing in their disclosure policies or practices can, and likely will, be exploited. Language must be carefully crafted so as to clearly define their members' obligations, to create black and white, rather than gray lines, and to fashion by preexisting agreement among the members appropriate remedies for breaching those obligations. Although it may not always be practical, SSOs should express, in writing and in practice, a preference for designing around patents or for securing RAND commitments from patent holders, so that it is easy to determine in hindsight what the SSO's most likely course would have been absent concealment. For its part, the FTC must now evaluate similar cases with the idea that an antitrust claim will only survive if the Commission can develop compelling proof that an SSO would have designed around a patent rather than merely requiring a RAND commitment.

---

<sup>1</sup> *In Re Rambus, Inc.*, 2006-2 Trade Cases P 75364, No. 9302, 2006 WL 2330117, 2006 FTC LEXIS 101 (F.T.C. Aug. 2, 2006), *available at* <http://www.ftc.gov/os/adjpro/d9302/060802commissionopinion.pdf>.

<sup>2</sup> *Rambus, Inc. v. F.T.C.*, 522 F.3d 456 (D.C. Cir. 2008).

<sup>3</sup> *Id.* at 459-60.

<sup>4</sup> *See In Re Rambus, supra* n.1, at 4.

<sup>5</sup> Before an SSO adopts a particular standard, there is significant competition between potential alternatives for incorporation into that standard. Once a standard is agreed upon and adopted, though, that competition quickly evaporates as the technology incorporated into the standard naturally begins to dominate the industry. In this case, 90% of DRAM production is compliant with the JEDEC standard, which incorporates technology covered by Rambus' patents. *See Rambus, supra* n.2, 522 F.3d at 459.

---

<sup>6</sup> While several JEDEC members negotiated licenses from Rambus, others refused and litigation ensued. *See id.*, at 460-61.

<sup>7</sup> *See generally In Re Rambus, supra* n.1, at 36-48, 66-68.

<sup>8</sup> *See id.* at 77-79.

<sup>9</sup> *Rambus, supra* n.1, 522 F.3d at 459.

<sup>10</sup> *Id.* at 461.

<sup>11</sup> *Id.* (citing *In Re Rambus, supra* n.1, at 51-59, 66).

<sup>12</sup> *Id.* (emphasis added, citing *In Re Rambus, supra* n.1, at 74).

<sup>13</sup> *Id.*

<sup>14</sup> *In Re Rambus, supra* n.1, at 119-20.

<sup>15</sup> *See In Re Rambus, Inc.*, Dkt. No. 9302, 2007 WL 431523 Opinion of the Commission on Remedy (F.T.C. Feb. 5, 2007), *available at* <http://www.ftc.gov/os/adjpro/d9302/070205opinion.pdf>, at 8 (hereinafter “Rambus Remedy Opinion”).

<sup>16</sup> *Id.* at 16-25.

<sup>17</sup> *See id.*; *Rambus, supra* n.2, 522 F.3d at 462.

<sup>18</sup> Rambus Remedy Opinion, *supra* n. 15, at 16-17.

<sup>19</sup> *Id.* at 19-25; *see also Rambus, supra* n.2, at 462.

<sup>20</sup> Rambus Remedy Opinion, *supra* n.15, at 27.

<sup>21</sup> *Rambus, supra* n.2, at 463.

<sup>22</sup> *Id.*

<sup>23</sup> *Id.* at 464.

<sup>24</sup> *Id.*

<sup>25</sup> *Id.* (citing *United States v. Microsoft Corp.*, 253 F.3d 34 (D.C. Cir. 2001)).

<sup>26</sup> *Id.* (citing *Conwood Co. v. U.S. Tobacco Co.*, 290 F.3d 768 (6th Cir. 2002)).

<sup>27</sup> *Id.* at 466.

<sup>28</sup> *Id.*

<sup>29</sup> *Id.* at 467.

<sup>30</sup> *Id.*

<sup>31</sup> *Id.* at 468.

<sup>32</sup> *See id.* at 467-68.

<sup>33</sup> *Id.* at 469.

---

<sup>34</sup> See, e.g., *Consolidated Metal Prods., Inc. v. Am. Petroleum Inst.*, 846 F.2d 284, 294 (5th Cir. 1988) (citing *Maple Flooring Mfrs. Ass'n v. United States*, 268 U.S. 563, 582-87 (1925)) (“[I]t has long been recognized that the establishment and monitoring of trade standards is a legitimate and beneficial function of trade associations.”); *Allied Tube & Conduit Corp. v. Indian Head, Inc.*, 486 U.S. 492, 501 (1988) (“When, however, private associations promulgate safety standards based on merits of objective expert judgments . . . , those private standards can have significant procompetitive benefits.”). The FTC itself openly acknowledges the benefit of SSOs. *In Re Rambus*, *supra* n.1, at 3 (“Standard setting . . . can be highly beneficial to consumers. Standards can facilitate interoperability among products supplied by different firms, which typically increases the chances of market acceptance, makes the products more valuable to consumers, and stimulates output. . . . Typically, the procompetitive benefits of standard setting outweigh the loss of market competition.”)

<sup>35</sup> See Mark Lemley, *Ten Things To Do About Patent Holdup of Standards (And One Not To)*, 48 B.C. L. Rev. 149, 154-55 (2007) (“*Patent Holdup*”); Joseph Farrell, John Hayes, Carl Shapiro & Theresa Sullivan, *Standard Setting, Patents, And Hold-Up*, 74 Antitrust L.J. 603, 616 (2007).

<sup>36</sup> *Patent Holdup*, *supra* n.35, at 154. See also David J. Teece & Edward F. Sherry, *Standards Setting And Antitrust*, 87 Minn. L. Rev. 1913, 1994 (2003) (demonstrating disproportionate cost to standards adopters from ex post patent attack).

<sup>37</sup> *Patent Holdup*, *supra* n.35, at 154-55 (emphasis added).